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FISCAL IMPACT STATEMENT

LS 6205 | **NOTE PREPARED:** Jan 1, 2011
BILL NUMBER: HB 1156 | **BILL AMENDED:**

SUBJECT: Elimination of Property Taxes.

FIRST AUTHOR: Rep. Thompson | **BILL STATUS:** As Introduced
FIRST SPONSOR:

FUNDS AFFECTED: X GENERAL
X DEDICATED
FEDERAL

IMPACT: State & Local

Summary of Legislation: This bill eliminates all ad valorem property taxes. It provides for the implementation of a local residential income tax, a local fire and safety benefit tax, a state commercial activity tax, and a state employer payroll expense tax to replace revenue lost to political subdivisions from the elimination of property taxes. The bill increases the state gross retail and use tax. It also reduces the state adjusted gross income tax rate. The bill makes other changes to the tax laws, and it makes appropriations.

Effective Date: July 1, 2011; January 1, 2012.

Explanation of State Expenditures: *Department of State Revenue (DOR):* The DOR would experience a significant increase in administrative responsibility and administrative cost due to this bill. The impacts are described below.

(1) There would be a significant increase in administrative cost to implement the commercial activity tax and employer payroll expense tax established by the bill, including new tax forms, new computer software, additional employees, and various other support expenses. The precise amount of the cost increase is indeterminable.

(2) It is assumed that the local residential income tax established by the bill would be reported and paid along with the state individual income tax. Collection and administration of this tax would require the DOR to revise income tax forms, update computer software, and track tax collections for each taxing district. This increase is indeterminable and will depend on the amount of resources that would be required to incorporate the various local taxing unit income tax rates.
(3) The changes to the sales tax rate and the individual income tax rate, and the elimination of the income

tax deduction for homeowner's property tax (due to elimination of the property tax), will require the DOR to revise income tax forms and update computer software. This increase is indeterminable and will depend on the amount of resources that would be required to incorporate these changes.

Explanation of State Revenues: The net impact on state revenue presented in the table below results from:

(1) the increase in the sales tax rate from 7% to 7.5% beginning January 1, 2012;
(2) the decrease in the individual adjusted gross income tax rate from 3.4% to 3% beginning July 1, 2011; and
(3) the elimination of property taxes beginning with Pay 2012 taxes, which will eliminate the revenue loss from the state individual income tax deduction for homeowner's property taxes beginning in tax year 2012.

Net Impact on State Revenue (In Millions)		
	FY 2012	**FY 2013**
Sales Tax Rate Increase (7% to 7.5%)	$161.6 M	$402.4 M
Income Tax Rate Decrease (3.4% to 3%)	(510.0 M)	(540.5 M)
Elimination of Income Tax Deduction for Homeowner's Property Taxes	0	57.1 M
Net Impact	**($348.4 M)**	**($81.0 M)**

Background Information: The revenue estimates relating to the tax rate changes are based on the Revenue Technical Committee Forecast (December 15, 2010) for the sales tax and the individual income tax. The revenue gain from the sales tax rate increase could potentially increase by about 3.5% annually after FY 2013. The revenue loss from the individual income tax rate decrease could potentially increase by about 4% annually after FY 2013. Since the bill increases the sales tax rate beginning January 1, 2012, the FY 2012 impact comprises five months of sales tax collections. The revenue gain due to the elimination of the income tax deduction for homeowner's property taxes is based on prior deduction levels and estimated property tax rate growth in future years. The estimate is also predicated on a 3% income tax rate.

Revenue from the individual income tax is distributed to the state General Fund. The bill directs all new revenues from the sales tax increase to the state General Fund, while holding the other funds to no change due to the rate increase. The bill changes the sales tax distribution as described in the table below.

Sales Tax Revenue Distribution		
Fund	**Current %**	**New %**
State General Fund	99.178%	99.225%
Public Mass Transportation Fund	0.670%	0.632%
Commuter Rail Service Fund	0.123%	0.116%
Industrial Rail Service Fund	0.029%	0.027%

The bill also changes the retail merchant collection allowances received by retailers through the collection allowance after the increase in the rate. This change has the same effective date as the rate increase provision. The table below shows the current allowance percentages and the new percentages under the bill.

Retailer's Sales Tax Collection Allowance		
Gross Sales Tax Liability	**Current %**	**New %**
Not more than $60,000	0.73%	0.68%
Greater than $60,000, not more than $600,000	0.53%	0.5%
Greater than $600,000	0.26%	0.24%

Explanation of Local Expenditures: *Lake County Homestead Property Tax Credit:* Since the bill eliminates property taxes beginning with Pay 2012 taxes, this will also will eliminate the revenue loss from the state individual income tax credit for property taxes paid by low-income Lake County homeowners. Since the revenue loss would be eliminated, Lake County, East Chicago, Gary, and Hammond would no longer have to reimburse the state General Fund for this revenue loss beginning in 2012. Under current statute, the revenue loss from the tax credit must be reimbursed by Lake County, East Chicago, Gary, and Hammond. It is estimated that the savings to these local units could potentially total $8.0 M to $8.5 M per year.

Under current statute, the tax credit is available to homeowners in Lake County who have earned income of less than $18,600. A homeowner who has earned income of less than $18,000 is entitled to a credit equal to the lesser of $300 or the amount of property taxes paid on the qualified homestead. The tax credit phases out for homeowners with earned income between $18,000 and $18,600. For every dollar of income more than $18,000, the tax credit is reduced by $0.50 until the credit is $0 for homeowners with an earned income exceeding $18,600. In 2008, 29,210 taxpayers claimed about $8.5 M in tax credits. Annually, the cost of the tax credit is reimbursed from Riverboat Admission Tax revenue. Annually, Lake County reimburses 50% of the credit cost, with Gary, Hammond, and East Chicago each reimbursing 16.67% of the credit cost. The reimbursement is withheld from Riverboat Admission Tax revenue paid to these local units.

Property Tax: Beginning with the March 1, 2011, assessment date under this bill, property would no longer be subject to assessment. No property taxes would be collected in CY 2012 or later years. The county would, however, continue to maintain a description of the property in the county. A substantial portion of the costs currently incurred by county and township assessor offices would be eliminated under this bill.

Explanation of Local Revenues: *Property Tax:* Beginning with taxes payable in 2012, property taxes may not be levied under this bill. In CY 2012, under current law, net property tax on real and personal property, after all credits is estimated at $6,164 M. The estimate is $6,276 M in CY 2013 and $6,374 M in CY 2014.

Local Residential Income Tax: Under this provision, each taxing unit would be able to impose an income tax on residents and some nonresidents who are employed in the taxing unit's tax area. The tax area for a school corporation is the area within the school corporation boundaries. The tax area for a municipality or for a taxing unit that lies totally within the boundaries of a municipality is the area within the municipality's boundaries. The tax area for all other taxing units is the entire county. The tax rate set by each taxing unit could not exceed the unit's budget amount less all other available revenues.

This tax would be collected by the DOR and distributed to the taxing units for which the taxes were collected. The fiscal impact of this provision depends on local action.

Fire and Safety Benefit Tax: This provision would allow a county, city, town, township, or fire protection district to impose a fire and safety benefit tax on all real property in the entity or in the entity's contract service area. Property that is currently exempt from property tax would be exempt from the tax under this provision. However, other property tax deductions would not apply to the assessment of this tax.

The tax may be determined based on any combination of (1) the acreage or frontage of the land, (2), the relative crime or fire risk of the property, and (3) the relative costs of special facilities or equipment needed to serve the property. Revenue from the tax may not exceed 50% of the total revenue needed for all public safety expenses, a bond sinking fund, and working capital.

This tax would be collected by the entity that imposes the tax. The county treasurer would collect delinquent taxes. The fiscal impact of this provision depends on local action.

Commercial Activity Tax: This provision would impose a tax on the gross receipts on entities doing business in Indiana. Each taxpayer would be entitled to a $1,000 deduction against their gross receipts base. The rate imposed against gross receipts would be 0.25%. Qualifying distribution center receipts would be exempt from the tax if (1) the distribution center has costs exceeding $500 M, (2) goods with more than 50% of the cost are shipped out of state, and (3) the distribution center pays an annual fee of $100,000.

This tax would be collected by the DOR and distributed to taxing units based on the percentage of statewide average business property value located in each taxing unit. The fiscal impact of this provision is currently indeterminable.

Employer Payroll Expense Tax: This provision would impose a tax on employers equal to 0.25% of pay for employees that are Indiana residents or perform work in Indiana. Local, state, and federal governments would be exempt from the tax as would state and nonprofit universities, any 501(c)(3) entity, and any other religious, charitable, scientific, literary, or educational entity so long as the entity's income is not used for private benefit.

This tax would be collected by the DOR and tracked by the taxing district in which each employee resides. The total collected for each taxing district would be distributed to taxing units in the district based on the proportion of each taxing unit's total budget to the total budgets of all units in the district. The fiscal impact of this provision is currently indeterminable.

Local Budgets: Under this proposal, local taxing units would submit their proposed budgets, tax rates, and tax levies to the county auditor for review by the county board of tax adjustment (TAB) or by the county auditor in a county without a TAB. The TAB (or the auditor) could accept, revise, reduce, or increase the tax levies, tax rates, and the part of the budget funded from taxes in order to enforce the tax limits.

The limits that currently apply to property taxes would apply to the revenues derived from the other taxes allowed under this bill. Overall, however, net revenues could increase for local civil taxing units and school corporations because there would be no loss of tax collections associated with the current property tax circuit breaker.

State Agencies Affected: Department of State Revenue; Department of Local Government Finance.

Local Agencies Affected: All; Lake County, East Chicago, Gary, and Hammond.

Information Sources: Revenue Technical Committee Forecast (December 15, 2010); OFMA property tax database.

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